

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
William Soller

MEMORANDUM

TO: Members of the Legislative Audit Committee
FROM: Angus Maciver, Legislative Auditor *AM*
DATE: October 2022
RE: Implementation of reforms to the financial audit model

At its June 2022 meeting the Audit Committee conducted a hearing on a report from its consultant Eide Bailly containing recommendations for changes in the Legislative Audit Division (LAD) financial audit model. We have spent the past few months considering the report's findings, conducting additional research, analyzing potential impacts, and discussing options directly with committee members.

The reforms discussed in the Eide Bailly report are far-reaching and would result in the most significant changes in Montana's financial audit model in more than a generation. These changes would, however, also orient us more closely with our peers in other states and would effectively implement an audit model that many others within our industry began adopting over twenty years ago. The main features of these changes are summarized as follows:

- Switching from a biennial to an annual federal Single Audit
- Focusing on timely completion of audits of statewide accounting and financial reporting
- Phasing-out biennial audits of every agency in favor of risk-based audits of financial activity
- Investing resources in information technology risk, data analytics, and quantitative methods

My recommendation is for the committee to proceed with the initial steps necessary to implement these changes. This process will be difficult and the transition is likely to last for the next 2-4 years. The Financial-Compliance audit team has analyzed the pros and cons of these changes and there are risks and uncertainties associated with these kinds of reforms. However, I firmly believe that this kind of change is inevitable and if we do not accomplish it now, a future Legislative Audit Committee will have to do so.

With the consent of the committee, we will begin preparing a detailed transition plan covering at least the next two biennia. The transition plan will need to address the many complex processes that support our current audit model, and we will need to work with colleagues in both state and federal governments to obtain their input. In the meantime, we suggest the following interim steps be considered by the committee as we head into the 2023 legislative session:

- **Prepare a committee bill draft for review at the December meeting** – the bill draft will address changes in the Legislative Audit Act that allow for flexibility when transitioning away from the current model. In simple terms, the current Audit Act language mandates we audit every agency every two years, but the proposed changes would allow us to decide when and how often to audit financial activity.
- **Coordinate Single Audit statutory authority with the federal government** – we cannot make immediate changes in the federal audit cycle and the FY 2022 – 2023 Single Audit must be performed on a biennial basis. We will need to work with our federal cognizant agent to determine how changes in the Audit Act would coordinate with federal Single Audit regulations, which may impact the timing or effective dates of proposed legislation.

- **Revise the agency audit schedule and appropriations** – as part of our budget submission for the 2025 biennium, we have identified eight small agencies where no audit work is necessary to support either statewide or federal reporting. We propose dropping these agencies from the schedule and eliminating the proposed HB2 audit appropriations from their budgets. Because many of these agencies rely significantly on general fund appropriations, this change redirects general fund authority to the legislature’s budget for risk-based audits.
- **Outsourcing the Montana State Fund financial statements audit** – we propose outsourcing the annual financial audit of State Fund by combining this work within the scope of an existing audit contract the agency has with a private CPA firm. State Fund is currently the best option for outsourcing work, without compromising risk mitigation or reporting timeliness. State Fund would still be subject to legislative audit authority and could still be included for risk-based work.
- **Risk-based information system audits at selected agencies** – to begin a transition to a risk-based model, we have identified some specific technology risk areas at certain agencies that should be subject to audit. This includes MDT, SITSD and the new ExploreMT licensing system at FWP. Requested appropriations associated with these audits will help offset revenue losses during the transition to a risk-based model.
- **Present law change package for operating** – we propose an additional \$25,000 in each fiscal year of the next biennium to fund increased technical training and professional certification support for LAD staff.
- **New Proposal for personal services** – we propose approximately \$50,000 additional personal services funding in each year of the next biennium for reclassification of an existing Associate Auditor position to provide for a new Deputy Legislative Auditor for Technology Risk and Data Analytics.

As stated, these are just preliminary steps in a multi-year process, but they will be important as the foundation for further action. For budgetary purposes, we are requesting an additional \$150,000 in funding through the next biennium to support some very significant changes in our business practices. However, we continue to believe that implementation of these changes will largely be a cost-neutral proposition for the legislature and will result in improved ability to manage and mitigate significant risks. The State of Montana currently spends roughly 0.05% of its \$10.5 billion in annual expenses on our audit effort. We don’t see a need to increase this proportion significantly and we continue to believe we can improve on this value proposition in future years.